STATE OF CALIFORNIA GRAY DAVIS, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

November 18, 2002

TO: PARTIES OF RECORD IN INVESTIGATION (I.) 99-07-003

Decision 02-11-031 is being mailed without the written dissent from both President Loretta M. Lynch and Commissioner Carl W. Wood. The dissent will be mailed separately.

Very truly yours,

Carol A. Brown, Chief
Administrative Law Judge

CAB:ham

Attachment

L/nas

MAIL DATE
11/15/02

Decision 02-11-031 November 7, 2002

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's Own Motion to Consider the Costs and Benefits of Various Promising Revisions to the Regulatory and Market Structure Governing California's Natural Gas Industry and the Report to the California Legislature on the Commission's Findings.	I.99-07-003 (Filed July 8, 1999)

ORDER DENYING APPLICATION FOR REHEARING OF DECISION (D.) 01-12-018

I. SUMMARY

By this Decision we deny rehearing of Decision (D.) No. 01-12-018 (the "Decision") sought by the Southern California Generation Coalition, The Utility Reform Network and the Department of General Services ("Applicants").

In D.99-07-015, we identified the most promising options for changes to the regulatory and market structure of the natural gas industry. In the Decision, we considered three contested settlement proposals addressing the options raised in D. 99-07-015 as applied to the Southern California Gas Company ("SoCalGas") natural gas system, and, to a lesser extent, the San Diego Gas and Electric Company ("SDG&E") gas system. The three settlements are known as the Interim Settlement Agreement (IS), the Post-Interim Settlement Agreement (PI) and the Comprehensive GAS OII Settlement Agreement (CS). The Commission chose to adopt the CS with certain modifications, because we believed that the CS would

provide significant benefits to all utility customers by allowing customers access to firm tradable transmission rights on SoCalGas' system. Those benefits are described in detail at page 2 of the Decision, and will not be repeated here.

At the close of the record in this proceeding, all three settlement options had supporters. The Applicants here all supported the IS, and urged that the Commission erred in adopting the CS. However, Applicants have demonstrated no legal error in the decision, but instead reargue the policy determinations that led up to the decision, which is not a proper subject for an application for rehearing. Further, SoCalGas, SDG&E and the Office of Ratepayer Advocates (ORA) point out in their response to the application (hereafter, " Response") that they and many other affected parties have already put substantial effort into implementation of the decision, which was effective upon its issuance and has not been stayed. The parties also point out that portions of the decision have been implemented already, other portions will be implemented shortly, parties have begun planning and relying on the provisions of the decision, and it would be extremely disruptive for the Commission to annul its decision when it is not legally obliged to do so (Response, pages 1-2.)

II. DISCUSSION

Applicants first argue that the decision is arbitrary and capricious in adopting a system that does not give noncore end-users an absolute and total right to acquire all firm intrastate backbone capacity before gas marketers or other persons. However, we would first point out that the Decision provides substantially preferential access for noncore end-use customers over gas marketers to obtain backbone transmission capacity rights on the system. In fact, Sections 1.1.3.6 through 1.1.3.6.3 provide for 50% of the total remaining backbone capacity at each receipt point after the SoCalGas core set aside must be made available to these customers in the first two phases of the open season. Only noncore end-use customers (not marketers) may participate in those first two phases, to the extent of their historical demand. All persons can participate in the third and final phase

of the open season in which all remaining capacity is available. Further, Exhibit 27 in this proceeding demonstrates that a large amount of capacity will be made available to noncore end-use customers, a total of approximately 1,163 MM cfd. (Response, page 3).

Applicants argue generally that there is no "policy, legal or factual justification" for the fact that the CS does not provide noncore end-use customers with the opportunity to obtain all the capacity they want in an open season before gas marketers can contract for any capacity. With regard to the policy argument, an application for rehearing is not the proper forum for such an allegation. Nor do applicants provide any specific allegation of any legal or factual errors in the Decision, other than the allegation that the decision is in violation of Sections 2771 and 2772 of the Public Utilities Code, which we deal with later in this opinion. This is in direct violation of our Rule of Practice and Procedure 86.1, which states, " … vague assertions as to the record or the law, without citation, may be accorded little attention."

Applicants next make the novel argument that the Decision is in error because its analysis of city-gate gas prices under the PG&E Gas Accord is refuted by a portion of the original Proposed Decision issued by Commissioner Bilas in 2000.

First, Applicants have failed to cite any legal authority for the proposition that the Commission is required to adopt the findings and conclusions contained in a proposed decision in its final decision. In fact, one of the principal reasons for proposed decisions is to allow for comment and potential changes reflecting those comments. Further, the language of the Proposed Decision issued by Commissioner Bilas in 2000 quoted by Applicants in Section 2 of the application for rehearing deals with a time period <u>after</u> the evidentiary record closed in this proceeding in mid-2000. There is no record evidence in this proceeding providing detailed information about PG&E's city-gate prices after mid-2000, nor is there any ruling or decision in this proceeding taking official

notice of any price information after the close of the record. Applicants attempt to rely on material not in the record that was recited in a Proposed Decision that was withdrawn and never adopted by the Commission. They may not do so.

Applicants next argue that the decision is inconsistent with Public Utilities Code Sections 2771 and 2772. The argument is not persuasive. Sections 2771 and 2772 generally require the Commission to establish a system for priority of service that reflects a consideration of the most important public benefits and the greatest public need for energy utility service. Applicants appear to argue that these sections require that every end-use customer must always have priority over any gas marketer to use utility facilities, and that the decision is unlawful because it does not provide such a guarantee. As we have already pointed out above, the Decision provides substantially preferential access to noncore end-use customers relative to gas marketers in contracting for backbone capacity. Furthermore, the Decision provides a complete reservation of priority of service for such core customers. Finally, Section 1.5.4 of the CS, approved by the Decision, provides for the involuntary diversion of whatever amount of noncore (or marketer) supplies on the system are necessary to avert interruption of service to core customers. (Response, page 6.)

We have attempted in the Decision to adopt an economically based system of priority for service other than to the core market. This is entirely consistent with prior decisions. In fact, as long ago as the December, 1986 decisions unbundling gas commodity and transportation service, we have endorsed the concept of a priority system that allows noncore customers to pay a "priority charge" in exchange for higher level of service. See D.86-12-009, 22 C.P.U.C. 2nd 444 at 473, Conclusion of Law 5 at 489 and D.86-12-010, 22 C.P.U.C. 2nd 491 at 508-510 and Conclusion of Law 54 at 566. The application for rehearing appears to argue that <u>any</u> system that allows persons other than end-use customers (such as gas marketers) to hold firm capacity rights when some noncore customers do not hold firm rights necessarily violates Sections 2771 and 2772. We reject this

argument. In fact, we have previously used an economically based system for allocating capacity in connection with the offering of unbundled storage service to gas marketers as well as end-use customers. See D.93-02-013, 48 C.P.U.C. 2nd 107, under which gas marketers can obtain storage service, and are treated on a non-discriminatory basis with noncore end-use customers. Moreover, the same principle has been applied in the approval of PG&E's Gas Accord, which allows any credit worthy party, not just noncore end-users, to participate in an open season for intrastate backbone transmission capacity. See D.97-08-055, 73 C.P.U.C. 2nd 754, Appendix B at page 808.

Applicants argue generally that the Decision is not supported by the evidence and does not contain the requisite Findings of Fact to comply with the requirements of a determination pursuant to Sections 2772 and 2773 of the Public Utilities Code. The Decision refutes this claim. Beginning at page 16, we have summarized the economic and other benefits of the CS, comparing it favorably with the Gas Accord adopted for PG&E in Northern California. The discussion there, and elsewhere in the Decision reflects our attempt to balance the interests of core customers with the need for competition within the industry. This is further reflected in Finding of Fact 14, which states: "14. The CS is supported by the largest number of parties of any settlement, including customer groups and the utilities. It provides some benefit to and balances the interests of gas suppliers, shippers, storage operators, wholesale and retail end-use customers, and regulatory representatives, as well as SoCalGas and SDG&E." Applicants' argument that the Decision is in violation of Sections 2771 and 2772 is without merit.

Applicants argue that the Decision somehow commits legal error because it adopts a price cap on secondary market transactions in intrastate backbone capacity, allegedly with "full knowledge that such a fix will not work." (Application, page 12). In support of this argument, Applicants quote from a statement by an unnamed party for SoCalGas at a workshop held on January 9, 2002, which was held after the close of record in this proceeding and cannot,

therefore, be used as a basis for an argument in an application for rehearing of the Decision.

Applicants cite a filing that the Commission made before FERC in December 2001 in Docket No. R.P. 10-180-000 in support of this argument. That case dealt with the Commission's interest in avoiding profiteering by interstate pipeline capacity holders. However, the purpose of our filing in the FERC proceeding was to support another filing that SDG&E had made (also supported by SoCalGas) asking FERC to re-impose its "as billed" cap on secondary market transactions in interstate pipeline capacity. Earlier in 2000, on a trial basis and only for assignments of less than one year, FERC had lifted its regulation capping the rate for secondary market transactions in interstate capacity rights at the "as billed" FERC-regulated rate the pipeline itself can charge for firm capacity. What the Commission was asking FERC to do with respect to interstate pipeline capacity is precisely the same thing that we are attempting to do in the Decision, eliminate price gouging by capacity holders. It is illogical to claim that, because the Commission urged FERC to impose a secondary market price cap for interstate capacity, that it follows that it is unlawful for the Commission in D.01-12-018 to adopt its own secondary market price cap on intrastate capacity when the two actions are consistent. Further, it also makes no sense for the Applicants to claim that this request by the Commission to FERC proves that the intrastate price cap adopted in the Decision is unenforceable.

Further, we would point out that the CS, adopted by the Decision, assigns a large amount of intrastate capacity directly to the core market at embedded costs, so the core market will not be adversely impacted by city-gate prices. Further, the CS also gives noncore end-users the first opportunity to contract for a large amount of intrastate capacity before marketers and other persons can participate in the open season to obtain this capacity. There are also market concentration limitations and provisions that prevent persons owning capacity rights from withholding that capacity from the market. Therefore, even if

the secondary market price cap in the Decision proves difficult to enforce, as alleged by Applicants, there should still be no adverse impacts on California gas consumers. In any event, this policy decision is supported by record evidence and thus does not constitute legal error. (Response, page 9.)

Applicants urge that the Decision is flawed because it was originally classified as a Rulemaking, but nevertheless proposes to adopt rates, in violation of the Commission's Rules of Practice and Procedure. The argument is without merit.

First, the parties filing this application for rehearing have never before raised this allegation of error, and it is now untimely. Public Utilities Code Section 1701.1 provides in part: "The commission's decision as to the nature of the proceeding shall be subject to a request for rehearing within ten days of that date [the date the commission decides the categorization of the proceeding]. If that decision is not appealed to the commission within that time period it shall not subsequently be subject to judicial review." This statutory ten-day deadline is also reflected in Rule 6.4 of our Rules of Practice and Procedure. The purpose of this statute and rule is to ensure that parties bring alleged errors in categorization to the Commission's attention in a timely manner so that they may be corrected promptly and at the outset of the proceeding.

Further, Rule 6(c)(1) provides that any OII shall include a categorization and a statement as to whether hearings will be needed, and this categorization triggers the ability of a party to contest it pursuant to Rule 6.4. Here, consistent with Rule 6(c)(1), the OII issued on July 8, 1999 at page 6 in Ordering Paragraph 4 stated "We preliminarily determined that this is a quasi-legislative proceeding and that evidentiary hearings will be required." No party, including those to the instant application for rehearing, filed a challenge to the categorization in the July 8, 1999 OII within 10 days or at any time prior to the filing of the application for rehearing here. Thus, Section 1701.1 and Rule 6.4 bar Applicants from raising the issue now on rehearing. (Response, page 12.)

Second, even if Section 1701.1 was not an absolute bar to raising the categorization issue on rehearing, and even if there were an incorrect categorization, Applicants were not prejudiced. Applicants have been provided with full notice and opportunity to be heard on cost issues. As mentioned earlier, the original rulemaking was converted to an OII in July, 1999. The OII stated that the Commission will "explore, in more detail, the anticipated costs and benefits related with the more promising structural changes" to the gas industry. (OII, July 8, 1999, p. 3) Further, one of the stated goals of the investigation was to ensure that customer rates reflect the costs of the services they receive. (OII, July 8, 1999, p. 5. Also, the Administrative Law Judge ("ALJ") issued a Ruling Regarding Scope of the proceeding on July 19, 1999. The ruling stated that the scope of the proceeding includes evidence of the costs in real dollar terms for each policy option discussed and a proposed allocation of costs and timeframe for recovery. These are all elements of ratemaking: What are the costs to be recovered; who is to bear those costs; how are the costs to be allocated among those who are to bear them; and over what period of time are they to be recovered. Applicants were thus on notice that the Commission intended to look at cost implications. If Applicants believed that the proceeding should have been recategorized from a rulemaking to a ratesetting proceeding rather than as an investigation, it was incumbent on the Applicants to comply with the purpose of the statute and rule by bringing this issue to the Commission's attention in a timely manner, in July, 1999.

It is noteworthy that the ALJ ruling also requested that parties introduce evidence on these issues. (ALJ Ruling, July 19, 1999, pp. 1 and 2.) Eight days of evidentiary hearing were then held, followed by oral argument before the Commission, as well as comments and reply comments to both the proposed decision and the revised proposed decision. Applicants do not identify in their Application for Rehearing any additional evidence they would have introduced at hearings if the proceeding had been categorized as ratesetting.

Applicants apparently believe that due to improper categorization of the proceeding, the Commission lacks authority to approve a settlement, which, among other things, directed SoCalGas to file an advice letter to effect an adjustment for implementation costs. To find that the Commission loses jurisdiction to act under these circumstances would be to place form over substance. Before the courts will find that a statute divests an agency of jurisdiction to act for its failure to comply with the statute, legislative intent must be shown to be mandatory and jurisdictional rather than merely directory. (California Corrrectional Peace Officers Assn. v. State Personnel Bd. (1995) 10 Cal. 4th 1133, 1145). In this case, the statute does not expressly state that a failure to properly categorize a proceeding will cause the Commission to lose jurisdiction.

The applicants could have filed petitions requesting that the Commission revise the categorization, if they believed it was in error. This could have been done at the time that the Commission converted the Rulemaking to an OII in July 1999. They did not do so, and are now barred from raising this argument by Section 1701.1. Moreover, for the reasons discussed above, if there was an error in categorization, it was at most a harmless error, since Applicants have not shown how they were prejudiced thereby.

Finally, applicants argue that Conclusion of Law 2, which is contained in both Proposed and Final Decisions, is somehow inconsistent with the balance of the final decision and therefore renders it unlawful. The Conclusion of Law states: "2. The market structure of the gas industry should be reformed cautiously in light of recent energy and gas price rises." Applicant does not state how this Conclusion of Law is in error. On rehearing, we conclude it is not.

The statement as contained in Conclusion of Law 2 is not inconsistent with any part of either decision, nor does it render the Final Decision adopted unlawful. We will point out passages of the text in the Decision that provide a clear and rational explanation of why the adoption of the CS is entirely consistent with Conclusion of Law 2. At pages 7 and 118, the Decision describes the

"measured steps" the Commission has taken over a period of approximately 15 years to adopt "cautious deregulation" of the natural gas market in California. The Decision recounts these steps starting in 1986, such as unbundling of transportation and commodity costs, institution of core transportation-only service, unbundling of storage service for noncore customers, and in 1997 the adoption of the Gas Accord for PG&E, which is very similar to the CS. The Decision further recounts the approximate four-year history of this proceeding, including the adoption of a goal in our July 1999 decision (D.99-07-015) to adopt a system comparable to what the Commission had previously adopted and implemented for PG&E. In this context, it is perfectly reasonable and consistent for the Decision to include Conclusion of Law 2 and to describe its adoption of the CS as "cautious reform."

Furthermore, the Decision adopts some significant modifications to the CS in light of recent extraordinary market conditions. This is another context in which it is entirely consistent and reasonable for the Decision to describe the action it takes as "cautious reform." For example, the Decision increased CS's reservation for the core of intrastate backbone capacity and storage inventory capacity. It reduces from 40% to 30% the maximum percentage of backbone capacity not allocated to the core that any individual customer may hold at a particular receipt point. It further imposes a ceiling on the secondary market price of backbone capacity at 120% of the imbedded cost of that capacity. These steps evidence the Commission's intent to move cautiously in deregulating the natural gas market to protect end-use customers.

III. CONCLUSION

Applicants have demonstrated no legal or factual error in the Decision and rehearing should be denied.

THEREFORE IT IS ORDERED that:

1. Rehearing of Decision No. 01-12-018 is denied.

2. This proceeding is closed.

This Order is effective today.

Dated November 7, 2002, at San Francisco, California.

HENRY M. DUQUE
GEOFFREY F. BROWN
MICHAEL R. PEEVEY
Commissioners

I will file a dissent

/s/ LORETTA M. LYNCH
President

I reserve the right to join President Lynch's dissent.

/s/ CARL W. WOOD
Commissioner